

**Additional Strategies Are Needed to
Ensure the Employee Plans
Compliance Resolution System Will
Accomplish Its Intended Purposes**

September 2003

Reference Number: 2003-10-190

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 12, 2003

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report - Additional Strategies Are Needed to Ensure
the Employee Plans Compliance Resolution System Will
Accomplish Its Intended Purposes (Audit # 200210048)

This report presents the results of our review of the Employee Plans Compliance Resolution System (EPCRS) programs. The overall objective of this review was to determine whether the Tax Exempt and Government Entities (TE/GE) Division implemented the processes for the EPCRS programs to accomplish its program goals and consistently apply the EPCRS guidelines.

In summary, the EPCRS programs are the centerpiece of the TE/GE Division's Employee Plans (EP) function's efforts to maximize voluntary compliance for more than 700,000 qualified plans with approximately 111 million participants and assets totaling more than \$4 trillion. In the 1990s, the Internal Revenue Service (IRS) initiated several methods to allow plan sponsors to correct deficiencies in their plans and retain their tax-exempt status. These methods were organized into the following three programs:

- The Audit Closing Agreement Program (ACAP), which allows plan sponsors to correct certain plan failures identified during an examination and negotiate a sanction to be paid to the IRS as a result of the plan failures.
- The Self-Correction Program (SCP), which allows plan sponsors to correct some operational errors without an IRS sanction and does not require the plan sponsor to report the correction to the IRS unless the error is identified during an examination.

- The Voluntary Correction Program (VCP), which allows plan sponsors to voluntarily notify the IRS of certain types of plan failures along with a proposed correction method.

The TE/GE Division created the Voluntary Compliance (VC) organization to provide the basis for growth of existing EPCRS programs and development of new programs, improve coordination and consistency across programs, simplify administration, and facilitate end-to-end accountability. Although EP function management has continued to place emphasis on the EPCRS programs and the EPCRS continues to be the centerpiece of their efforts to maximize voluntary compliance, the TE/GE Division has not established clear, measurable EPCRS goals for the three EPCRS programs. The EPCRS revenue procedure establishes general principles for implementing the system, but it does not contain measurable program goals. Without measurable goals, it is difficult for management to develop processes for evaluating whether the underlying principles of the EPCRS are being achieved in the most effective manner.

In addition, EPCRS procedures do not ensure similar plan failures are handled consistently among different EP function offices. For example, Examinations Program coordinators were using different ranges to determine the ACAP sanctions. Also, some plan sponsors may have to use ACAP procedures and pay a sanction to correct operational failures that other plan sponsors are allowed to self-correct.

Furthermore, the TE/GE Division has not established appropriate goals and measures for the EPCRS programs in the annual EP Examinations Program operating plan. As a consequence, no accountability exists for achieving improvements expected from the VC organization. For example, EP function management identified some Examinations function employees incorrectly closing some self-correction cases as “no change” cases. While EP function management was unsure why the cases were closed in this manner, they suspect that using the “no change” closing procedures assisted in meeting the cycle time goals for the Examinations Program. When using SCP procedures, employees are required to verify that the plan sponsor has appropriately corrected the failure before closing the case.

We recommended that the Director, EP function, develop measurable participation goals for each EPCRS program, along with a method to measure the results, and develop a process to measure the impact of marketing and outreach efforts. The Director should also implement standardized procedures for determining ACAP sanctions and the significance of plan failures, establish measures to incorporate EPCRS goals into the Examinations Program, and reemphasize the proper Examinations Program closing procedures for operational failures corrected using the SCP.

Management’s Response: The Commissioner, TE/GE Division, generally agreed with our findings and recommendations but had concerns on how to implement some of the recommendations. EP function management acknowledged that they have not established numerical goals for the number of corrections made under the three EPCRS programs and stated several reasons why that would be difficult to do. However, the EP function will continue to work with its stakeholders to determine the effect the

correction programs have on compliance. The Treasury Inspector General for Tax Administration (TIGTA) believes that participation goals are one indicator of whether customers are using EPCRS programs. If EP function management does not want to develop participation goals, they should consider establishing other goals to determine whether EPCRS programs are actually increasing voluntary compliance or if plan sponsors are voluntarily ensuring their plans are compliant.

Also, the Commissioner, TE/GE Division, indicated that EP function management will analyze the feasibility of surveying applicants under the VCP to help determine the impact of outreach activities on use of the correction programs. To address consistency issues for the SCP and ACAP, EP function management plans to test three ACAP sanction structure proposals and is developing a peer review process to review cases closed under the SCP and ACAP. The VC organization is developing a webpage to provide tools to assist in the consistent application of the EPCRS.

Finally, the Commissioner responded that EP function management is proposing adding a commitment to each area manager's Performance Management System for Fiscal Year 2004 to evaluate ACAP and SCP training needs, communicate the requirement to use procedures outlined in Revenue Procedure 2003-44,¹ and identify and address barriers. While this proposed action may bring accountability to the area managers and improve the accuracy of ACAP and SCP cases, the TIGTA believes it does not provide EP function management with assurance that the EP function staff are correctly closing cases consistently nationwide, or that closing procedures are consistently communicated nationwide. If EP function management decides not to include this in the Performance Management System, alternative actions will still be needed. Also, consistency may be improved by having the Director, EP Examinations, communicate the requirements. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

¹ Revenue Procedure 2003-44 describes the comprehensive system of correction programs for sponsors of retirement plans. This system, the EPCRS, permits plan sponsors to correct plan failures and thereby continue to provide employees with retirement benefits on a tax-favored basis.

**Additional Strategies Are Needed to Ensure the Employee Plans Compliance
Resolution System Will Accomplish Its Intended Purposes**

Table of Contents

| | |
|---|---------|
| Background | Page 1 |
| Measurable Goals and Processes Need to Be Established for the Employee Plans Compliance Resolution System Programs | Page 3 |
| <u>Recommendation 1:</u> | Page 7 |
| <u>Recommendation 2:</u> | Page 8 |
| Standardized Procedures Are Needed to Ensure Case Actions Are Consistent | Page 8 |
| <u>Recommendation 3:</u> | Page 11 |
| Accountability for the Employee Plans Compliance Resolution System Should Be Included in the Examinations Program | Page 12 |
| <u>Recommendation 4:</u> | Page 13 |
| <u>Recommendation 5:</u> | Page 14 |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 15 |
| Appendix II – Major Contributors to This Report | Page 16 |
| Appendix III – Report Distribution List | Page 17 |
| Appendix IV – Management’s Response to the Draft Report | Page 18 |

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

Background

The Tax Exempt and Government Entities (TE/GE) Division's Employee Plans (EP) function is responsible for administering the tax code for more than 700,000 qualified plans with approximately 111 million participants and assets totaling more than \$4 trillion. These qualified plans include various employee benefit plans, such as pension plans, profit-sharing plans, Internal Revenue Code section 401(k) retirement plans, employee stock ownership plans, and stock bonus plans. In the past, when deficiencies were identified in a plan, Internal Revenue Service (IRS) management did not have any remedies to correct a plan's failures other than to revoke its tax-exempt status. This action has tremendous consequences for the individuals participating in those plans because their retirement benefits may then become taxable.

To fill this void, in the 1990s, the IRS initiated several methods to allow plan sponsors to correct deficiencies in their plans and retain their tax-exempt status. These methods were eventually organized into the following three programs:

- The Audit Closing Agreement Program (ACAP) was developed within the Examinations Program and allows plan sponsors to correct certain plan failures identified during an examination and negotiate a sanction to be paid to the IRS as a result of the plan failures. The EP function reported that it closed 157 ACAP cases for the first 10 months of Fiscal Year (FY) 2002 and collected \$3.2 million of associated sanctions.
- The Self-Correction Program (SCP) allows plan sponsors to correct some operational errors without an IRS sanction and does not require the plan sponsor to report the correction to the IRS unless the error is identified during an examination. As a result, the IRS does not know the total number of plan sponsors that have corrected plans using this method.
- The Voluntary Correction Program (VCP) allows plan sponsors to voluntarily notify the IRS of certain types of plan failures along with a proposed correction method. The plan sponsors submit a processing fee (not a sanction) to obtain the IRS' written agreement on the appropriate correction method. The EP function

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

reported that it closed 780 VCP cases for the first 10 months of FY 2002 and collected \$3.2 million in processing fees.

In 1998, the correction methods were rolled into one system called the Employee Plans Compliance Resolution System (EPCRS) revenue procedure. The EPCRS revenue procedure is based on general principles that include encouraging plan sponsors to voluntarily correct plan failures, enabling plan sponsors to make corrections in a timely and efficient manner, and ensuring that the programs are consistently administered within the EP function. The EPCRS revenue procedure also outlines the eligibility and processing requirements for each of the three programs and is periodically updated to add new methods or change the eligibility requirements.

Prior to FY 2002, the three EPCRS correction programs were administered by different offices within the TE/GE Division. Due to inconsistencies in the way the offices governed the three correction programs, the TE/GE Division modernization redesign team created the Voluntary Compliance (VC) organization, which was staffed in February 2002. The expectations for the VC organization included the following:

- Provide the basis for growth of existing EPCRS programs and development of new programs.
- Improve coordination and consistency across programs.
- Simplify administration and facilitate end-to-end accountability of the EPCRS.

To assist in the consistent application of EPCRS procedures, EP function management created the Voluntary Compliance Council (VCC), consisting of members from the Rulings and Agreements, Examinations, VC, and Customer Education and Outreach (CE&O) functions. The VCC is responsible for the development of processes, procedures, and published guidelines on voluntary compliance matters that cross the Examinations and Rulings and Agreements functions. EP function management created the Central

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

Coordination Committee (CCC), consisting of all the coordinators from the Examinations, Determination, and VC functions. The CCC is responsible for ensuring that EPCRS procedures are consistently applied across the three functions.

The audit was conducted in accordance with *Government Auditing Standards* at the VC organization office located in Washington, D.C., and in selected EP function field offices nationwide between January and June 2003. Data used in this report on the number of plans, plan participants, and total assets came from various IRS reports. As such, we did not verify the accuracy of the information from those sources. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Measurable Goals and Processes Need to Be Established for the Employee Plans Compliance Resolution System Programs

EP function management has continued to place emphasis on the EPCRS programs, and the EPCRS continues to be the centerpiece of their efforts to maximize voluntary compliance, as stated in their FY 2003 Annual Work Plan. However, the TE/GE Division has not established clear, measurable goals for the three EPCRS programs. The EPCRS revenue procedure establishes general principles for implementing the system, but it does not contain measurable program goals. For example, the general principles encourage plan sponsors to self-identify and correct plan failures. However, the TE/GE Division has not defined how the term “encourage” should be measured and has not set a numerical goal for the number of corrections made under the EPCRS programs. Without measurable goals, it is difficult for management to develop processes for evaluating whether the underlying principles of the EPCRS are being achieved in the most effective manner.

Growth of existing EPCRS programs

Among the expectations of the EP function’s voluntary correction programs were to have more plan sponsors use the EPCRS programs and to develop new programs for plan sponsors who did not qualify for the current EPCRS programs. To meet these expectations, EP function management continues to expand eligibility requirements for the EPCRS programs. For example, the

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

SCP program was expanded in May 2001 to permit small employers to self-correct insignificant Simplified Employee Pension failures, and the VCP was expanded in July 2002 in the area of anonymous submissions. However, the TE/GE Division had not established program goals to evaluate whether the expectations of the new programs are being met or the effect each program has on the other.

One incentive for plan sponsors to use either the SCP or VCP is the substantial amount of sanctions that can be associated with the ACAP cases that are identified during an EP examination. Because ACAP cases are dependent upon the numbers and types of examinations (e.g., if there are fewer examinations, there will be fewer opportunities to identify plan failures that result in ACAP closures), TE/GE Division management believes it would be difficult to establish ACAP goals.

Two components of management accountability, as defined by the Office of Management and Budget Circular A-123, *Management Accountability and Control*, are that managers are expected to increase program productivity and control program costs. In addition, the Government Performance and Results Act of 1993 (GPRA)¹ requires that major functions of operations specify in their annual plans the general goals and objectives, including outcome-related goals, to determine the skills, technology, and human capital necessary to achieve these goals. However, because measurable goals have not been established for the three EPCRS programs, EP function management cannot evaluate whether EPCRS programs are actually increasing voluntary compliance in an effective manner.

The only EPCRS measurable goal the TE/GE Division included in its FY 2002 Annual Work Plan was the total number of VCP cases closed compared to an estimated number. The estimated number includes a compilation of factors, such as an estimated number of submissions,

¹ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

prior year closures, and an adjustment for an estimated increase of SCP cases. However, this type of goal is difficult to attain because EP function management may not always be able to accurately estimate the number of VCP submissions that will be received. If the volume of submissions drops, there will be fewer cases to work and fewer closures. This is what occurred in FY 2002. The number of VCP closures decreased, and EP function management believes that plan sponsors were using the SCP instead of the VCP; however, there are no objective data to validate this assertion. Because plan sponsors are not required to report SCP corrections, it is difficult for EP function management to know whether use of the SCP has actually increased.

The TE/GE Division has not established a measurable goal for the SCP because it has been unable to develop a feasible method by which to capture the number of participants without discouraging their participation. TE/GE Division management considered including the SCP as a question on the Annual Return/Report of Employee Benefit Plan (Form 5500); however, they thought plan sponsors would be reluctant to answer the question for fear an examination might result. Another method considered was to require all EP Examinations function employees to request the SCP packages from the plan sponsor during the initial interview to document the number of participants in the SCP; however, TE/GE Division management decided this line of questioning could also discourage the use of the SCP.

Because the SCP is such an important, but currently unmeasured, part of the EPCRS, EP function management should consider participation goals for this program that can be measured. EP function management should consider collecting these data using customer surveys or, at a minimum, requiring that examiners include an SCP question in their initial interviews. EP function management agreed to consider these alternatives, but stated the surveys would not provide a complete picture of the use of the SCP. For example, EP function management could send customer surveys to those who had been examined in the past year asking

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

how many had self-corrected, but only a small percentage of the population is examined. TE/GE Division management will need to determine whether this type of limited quantifiable data for the SCP will be of benefit to the EP function.

Marketing EPCRS programs

In November 2002, VC organization management worked with the CE&O function to create a VC organization marketing plan with two established goals. The first goal is to make every plan sponsor aware of the necessity of internal control and monitoring systems for ensuring retirement plans are in compliance with the law. The second goal is to increase the use of EPCRS correction programs offered by the IRS.

To accomplish these goals, the VC organization is creating educational material with technical guidelines that explain the requirements for maintaining employee plans, flowcharts that guide the applicant through the eligibility process of each program, and a section that provides responses to frequently asked questions. The educational material will be available on the IRS Retirement Plans web site.

In addition, the CE&O function continually works with the VC organization to schedule speeches, benefit conferences, and panel discussions that educate customers and promote the various EPCRS programs. As of February 2003, EP function employees had either performed or scheduled over 160 of these events for FY 2003.

EP function management informed us that customers are aware of the EPCRS programs. For example, the participants in the EPCRS seminars verbally informed the presenters that they are using the SCP instead of the VCP. Although EP function management is able to quantify the number of presentations given, they have not established an effective process that will substantially evaluate whether the educational and marketing efforts will achieve the desired goals in the

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

VC organization marketing plan, as required by the GPRA.

Expanding and promoting EPCRS programs will assist sponsors in the identification and correction of plan failures. However, because EP function management has not established an effective way to measure the impact of these educational and marketing efforts on compliance, they cannot determine whether the appropriate amounts of resources have been applied to increase voluntary compliance through increased marketing of the EPCRS programs.

Recommendations

1. The Director, EP function, should develop measurable participation goals for each EPCRS program, along with a method to measure the results. TE/GE Division management will also need to determine whether limited quantifiable data for the SCP will be of benefit to the EP function.

Management's Response: EP function management does not believe use of formal surveys is a feasible alternative in measuring the use of the SCP and establishing participation goals for this program. With respect to the VCP, the number of applications received is not within the IRS' control. Establishing participation goals for the ACAP is both difficult and troubling. However, the EP function will continue to work with its stakeholders to determine the effect its correction programs have on compliance and solicit suggestions on ways to improve the EPCRS programs.

Office of Audit Comment: Participation goals are one indicator of whether customers are using EPCRS programs. If EP function management does not want to develop participation goals, they should consider establishing other goals to determine whether EPCRS programs are actually increasing voluntary compliance or if plan sponsors are voluntarily ensuring their plans are in compliance with the law.

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

2. The Director, EP function, should develop a process to measure the impact of the marketing and outreach efforts on the desired marketing goals.

Management's Response: The Director, EP CE&O, will request that the number of visits during FY 2004 to the correction topic of the Retirement Plans webpage be tracked. In addition, EP function management will track the number of EPCRS products distributed as well as the number of speeches delivered by EP function representatives and the number of speech attendees. During FY 2004, EP function management will analyze the feasibility of surveying applicants under the VCP to help determine the impact of outreach activities on use of the correction programs.

Standardized Procedures Are Needed to Ensure Case Actions Are Consistent

Another expectation of the new VC organization is to improve coordination and consistency among programs. This expectation coincides with the EPCRS general principle that these programs be administered in a consistent and uniform manner. However, we found that EPCRS procedures do not ensure similar plan failures are handled consistently among different EP offices within the Examinations, Determination, and VC functions.

Establishing fees or sanctions

After the EP function identifies a failure that will disqualify a plan, an employee works with the designated EPCRS coordinator to arrive at the appropriate correction method and the amount of any fee or sanction. Because of the wide variety of plans and the level of significance of plan failures, it is difficult to set specific sanction amounts that would equitably address every type of plan failure. The EPCRS coordinators and the two councils are intended to help ensure consistency in this process. It is the coordinators' responsibility to ensure the different EP offices consistently apply an appropriate correction method and fee or sanction. If a coordinator has a question or concern with the EPCRS procedures or case actions, the issue can be elevated to the CCC.

Nonetheless, each coordinator, along with his or her manager, must determine whether a proposed action should

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

be implemented. In addition, EPCRS correction methods and sanctions are not subject to a centralized review that would ensure consistent case actions. This latitude presents a risk that sanction amounts will be determined inconsistently and result in inequitable treatment of customers.

We identified an area that might result in inconsistent treatment. The six Examinations Program coordinators do not agree on a standard range for the ACAP sanctions. As a result, each coordinator works with individual EP function employees to assist the employee in negotiating a sanction amount with the plan sponsor. The sanction amounts are generally negotiated within a range that could be as high as the amount of tax if the plan was disqualified, and as low as the amount the plan sponsor would have paid in processing fees if the sponsor had volunteered to correct the failure using the VCP. The VCP fees are grouped into six different ranges depending upon the number of plan participants. The processing fees could range anywhere from \$500 to \$70,000, with the suggested amount being the median within each range. Three of the Examinations Program coordinators advised us that they used the median amount as their low end, and the other three advised us that they used the high end of the VCP range as their lower limit.

Only the VC organization has decided to implement a fixed fee structure for all VCP cases, which will ensure consistent processing fees. These new VCP procedures were incorporated into the EPCRS revenue procedure² issued in June 2003. EP function management recognizes that similar guidelines in determining ranges for ACAP sanctions are needed in the Examinations Program to ensure more consistency in that Program and has developed six different proposals. They are still evaluating the proposals and have not yet agreed on the appropriate method.

² Revenue Procedure 2003-44 describes the comprehensive system of correction programs for sponsors of retirement plans. This system, the EPCRS, permits plan sponsors to correct plan failures and thereby continue to provide employees with retirement benefits on a tax-favored basis.

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

Deciding the significance of the failure

Another EPCRS case action that may be inconsistently administered is the decision to determine the significance of a plan's operational failure. If the operational failure identified during an EP function examination is insignificant, EPCRS procedures allow the plan sponsor to self-correct under the SCP. If the failure does not qualify for the SCP, EPCRS procedures state the plan sponsor would need to correct it using the ACAP and also pay a sanction.

The EPCRS revenue procedure provides several elements that should be considered when deciding the significance of a plan failure; however, the decision is left to the group managers. Some of these factors include:

- The number of plan participants that are affected by the failure.
- The percentage of plan assets involved in the failure.
- The number of years operating with a failure.

If the correction method is not covered in the EPCRS revenue procedure or if the group manager needs assistance, cases should be elevated to the Examinations Program coordinator. However, five of the six Examinations Program coordinators have no set percentages or standards to use when deciding whether a plan failure qualifies for the SCP. One Examinations Program coordinator interpreted procedures differently from the others by qualifying all cases for the SCP if only 1 year was involved. Other Examinations Program coordinators had not set standards for this decision and stated that cases are individually evaluated based on the facts.

Using the CCC to resolve inconsistencies

EP function management established the CCC to resolve any inconsistent application of EPCRS procedures. The first issue of establishing EPCRS fees and sanctions requires the EP function to coordinate the activities of the Examinations, Determination, and VC functions to reasonably ensure that customers are receiving consistent treatment. The second issue of deciding the significance of

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

an operational failure during an examination involves only the Examinations function.

These two issues have been discussed by the CCC. The CCC decided to establish a fixed-fee structure for VCP cases but did not decide on the appropriate range for ACAP cases. For the decision on whether an operational failure is significant and qualifies for self-correction, the drafted procedures state the decision should be based on the suggested elements of the case. However, based on our discussions with the Examinations Program coordinators, the procedures need to be more clearly defined to ensure more consistent determinations of the level of significance of plan failures.

EP function management needs to develop standard procedures along with processes that will ensure the EPCRS procedures are consistently applied, both within the three EP functions and across functional lines. The existing process does not provide reasonable assurance that coordinators are applying the EPCRS in a consistent manner. As a result, similar plan sponsors with the same types of plan failures may be assessed different sanctions because they operate in different geographic areas. In addition, some plan sponsors may have to use ACAP procedures and pay a sanction to correct operational failures that other plan sponsors are allowed to self-correct.

Recommendation

3. The Director, EP function, should implement standardized procedures for determining ACAP sanctions and the significance of plan failures. Also, a process should be developed to ensure these procedures are consistently applied.

Management's Response: During FY 2004, EP function management will test three ACAP sanction structure proposals to determine the impact on compliance and consistency. Also, the area coordinators are developing a peer review process to review cases closed under the SCP and ACAP in an effort to promote consistency. In addition, the VC organization is developing a webpage that will

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

Accountability for the Employee Plans Compliance Resolution System Should Be Included in the Examinations Program

provide tools to assist in the consistent application of the EPCRS, such as closing agreement templates, a catalog of issues addressed by the CCC, and answers to questions received from taxpayers.

The TE/GE Division has not established appropriate goals and measures for the EPCRS in the annual EP Examinations Program operating plan. As a consequence, no accountability exists for achieving improvements expected from the VC organization. For example, one of the expectations of reorganizing the EP voluntary correction programs was to simplify administration and facilitate end-to-end accountability. Since March 2002, VC organization management has been responsible for working all of the new VCP cases from beginning to end and is in the process of implementing a centralized inventory system to control these cases, as well as the ACAP and SCP cases. While the centralized inventory system will facilitate administration of EP voluntary correction programs, the VC organization still does not have control over the Examinations function, which works all of the ACAP and SCP cases.

The CCC, along with VC organization management, provides guidance to EP Examinations function employees working SCP and ACAP cases. However, the Examinations and Determination Programs do not have established goals for the EPCRS in their work plans. This creates a risk that the EPCRS programs may not be given the proper priority. One such risk was recorded in the minutes of a VCC meeting. EP function management stated that operational reviews had identified cases where some Examinations function employees incorrectly allowed plan sponsors to self-correct operational failures and closed the cases as “no change” instead of using SCP procedures.

While EP function management was unsure why the cases were closed in this manner, they suspect that using the “no change” closing procedures assisted in meeting cycle time goals for the Examinations Program. When using SCP procedures, employees are required to verify that the plan sponsor has appropriately corrected the

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

failure before closing the case. Verifying the correction requires more work and, consequently, increases the amount of time needed to close the case.

Because EP Examinations function employees may not be properly recording these SCP cases, EP function management is not getting an accurate assessment of their efforts to increase compliance. This could also affect the EP Examinations function's Risk Assessment Program if plans requiring self-correction are closed as a "no change." If there are sufficient numbers of these incorrect closures, the applicable market segments could reflect an overstated level of compliance. Including EPCRS measures in the Examinations Program plan would establish accountability for achieving EPCRS program goals in addition to Examinations Program goals.

Recommendations

4. The Director, EP function, should establish appropriate measures to incorporate EPCRS goals into the EP Examinations Program so Examinations function employees are accountable for both EPCRS and Examinations Program goals.

Management's Response: EP function management does not believe that the incidence of plan errors can be predicted and does not want to create a situation in which the establishment of program goals may affect either the examination selection process or the outcome of any case. Instead, the Director, EP Examinations, is proposing adding a commitment to each area manager's Performance Management System for FY 2004 to evaluate ACAP and SCP training needs, communicate the requirement to use procedures outlined in Revenue Procedure 2003-44, and identify and address barriers.

Office of Audit Comment: While this proposed action may bring accountability to the area managers, it does not provide EP function management with assurance that the EP function staff are correctly closing cases consistently nationwide. Also, if EP function management decides not

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

to include this in the Performance Management System, alternative actions will still be needed.

5. The Director, EP function, should reemphasize the proper Examinations Program closing procedures for operational failures corrected using the SCP.

Management's Response: EP function management is proposing adding a commitment to each area manager's Performance Management System for FY 2004 to evaluate ACAP and SCP training needs, communicate the requirement to use procedures outlined in Revenue Procedure 2003-44, and identify and address barriers.

Office of Audit Comment: While this proposed action may improve the accuracy of ACAP and SCP cases, it does not provide EP management with the assurance that closing procedures are consistently communicated nationwide. Consistency may be improved by having the Director, EP Examinations, communicate the requirements.

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Tax Exempt and Government Entities (TE/GE) Division implemented the processes for the Employee Plans Compliance Resolution System (EPCRS) programs to accomplish its program goals and consistently apply the EPCRS guidelines. Specifically, we:

- I. Determined whether TE/GE Division management had established measurable EPCRS goals and processes for accomplishing those goals.
 - A. Identified the measurable EPCRS goals for each of the three Employee Plans (EP) components that were included in the EP function's Fiscal Year 2002 Annual Work Plan.
 - B. Evaluated the EP function processes to determine if the necessary information was captured to measure the EPCRS program goals.
- II. Determined whether TE/GE Division management had established the necessary processes to ensure all EPCRS cases that are reported to the Internal Revenue Service (IRS) are controlled and monitored.
 - A. Identified the processes the EP function used to ensure the EPCRS cases reported to the IRS are controlled.
 - B. Evaluated the EPCRS inventory system to determine if the system will provide TE/GE Division management with the information necessary to monitor the EPCRS program goals.
- III. Determined whether TE/GE Division management had established the necessary processes to coordinate the efforts among the three different EP function components to ensure EPCRS procedures are applied in a consistent manner.
 - A. Identified the processes the EP function used to ensure the EPCRS procedures were applied in a consistent manner by the three EP function components.
 - B. Interviewed all of the EPCRS field coordinators to evaluate whether their involvement would ensure EPCRS guidelines were applied in a consistent manner.

**Additional Strategies Are Needed to Ensure the Employee Plans Compliance
Resolution System Will Accomplish Its Intended Purposes**

Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy Nakamura, Director

James Westcott, Audit Manager

Robert Nicely, Senior Auditor

Michael Van Nevel, Senior Auditor

Marjorie Stephenson, Auditor

**Additional Strategies Are Needed to Ensure the Employee Plans Compliance
Resolution System Will Accomplish Its Intended Purposes**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Employee Plans, Tax Exempt and Government Entities Division SE:T:EP
Director, Employee Plans Examinations, Tax Exempt and Government Entities Division
SE:T:EP:E
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities
Division T:CL

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

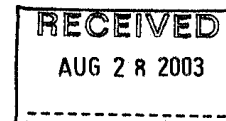
Appendix IV

Management's Response to the Draft Report

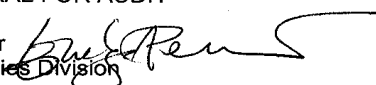


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

AUG 25 2003



MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Evelyn A. Petschek, Commissioner
Tax Exempt and Government Entities Division 

SUBJECT: Management Response to Draft Audit Report: Additional Strategies Are Needed To Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes (Audit # 200210048)

I have reviewed your draft audit report on the Employee Plans Compliance Resolution Program (EPCRS). Your auditors' examination of the procedures applicable to the EPCRS was exhaustive, and we appreciate the effort that went into developing this report.

As you point out, the EPCRS programs were developed by the Employee Plans (EP) function of the Tax Exempt and Government Entities (TE/GE) Division, and they are the centerpiece of EP's efforts to promote voluntary compliance in the retirement plans it regulates.

The first of EP's retirement correction programs was established in 1989, applied only on audit, and was limited in scope. Over the next several years, EP expanded this program and established several voluntary correction programs, culminating in 1998 with the creation of the EPCRS, which is designed to encourage early detection and correction of plan failures.

The evolution from a limited audit program to a fully developed system of correction programs was achieved through a variety of mechanisms, not the least of which was the development of a relationship of mutual cooperation and respect between EP and its outside stakeholders. Through EP's considerable partnering efforts EP has learned of the needs of its constituents and how its compliance efforts to date have been faring. In an area where the behavior that gives rise to regulation (i.e., the establishment of a retirement plan) is not mandated by law, and where the objective of a function's compliance efforts is to reduce the number of situations in which IRS involvement is necessary (either through the reduction of the error rate or through the use of the Self-Correction Program), an objective measurement of the programs' success can be elusive. For example, at partnering and outreach events over the years, EP has been informed that the SCP is the program of choice; that it is used much more heavily than

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

2

the VCP. However, one reason for its popularity is the anonymity of the user; there is no contact with the IRS, no submission or reporting requirement.

While we generally agree with the recommendations in this report, as we expressed during the course of the audit, we have concerns with how they could be implemented.

Our comments on the recommendations in the report are as follows:

Recommendation 1:

The Director, EP, should develop measurable participation goals for each EPCRS program, along with a method to measure the results. However, TE/GE Division management will also need to determine whether limited quantifiable data on the Self-Correction Program (SCP) will be of benefit to the EP function.

Comment:

As you state in your report, EP functional management has not set a numerical goal for the number of corrections made under the EPCRS programs. During the audit, EP relayed several reasons why that is difficult to do. With respect to the SCP, of course, even if EP could determine the total number of retirement plans and the types and designs of such plans in order to determine the number of errors that could possibly occur, it would still have to rely on probability as to the incidence of error, the correction of those errors, and the correction of those errors under the SCP (as opposed to correcting the errors under the VCP or under no correction program at all). Absent any quantifiable frames of reference, EP could, as you suggest, consider collecting data using customer surveys or, at a minimum, require examiners to include an SCP question in their initial interviews. As you state in your report, we agreed to consider these alternatives but stated the surveys would not provide a complete picture of the use of SCP. For example, EP function management could send customer surveys to those who had been examined in the past year asking how many had self-corrected, but only a small percentage of the population is examined. Furthermore, it is questionable as to whether a plan sponsor would be willing to "report" its use of the SCP, and the probability of such questioning may result in a bar to the use of the program.

As suggested in your report, we have not developed a feasible method by which to capture the number of participants in the SCP without concomitantly discouraging participation in the program. Some alternatives we had considered include adding a question relating to the use of the SCP on the Annual Return/Report of Employee Benefit Plan (Form 5500) and requiring EP Examinations employees to request SCP packages from plan sponsors during initial audit interviews to document the number of participants in the SCP. Feedback on both these alternatives indicated that they would discourage the use of the SCP. Similarly, upon informal questioning of practitioners as to how some sort of reporting requirement might impact the program, responses were consistently and overwhelmingly negative.

Balancing the cost of conducting formal surveys and the limited benefit achieved, we do not believe use of formal surveys a feasible alternative in measuring the use of the SCP

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

3

and establishing participation goals for this program. Nevertheless, EP would like to be able to measure the use of the SCP in some meaningful way, and we welcome any suggestions you may have to accomplish this goal.

With respect to the VCP, while the Service can encourage use of the program, the number of applications received is not within the Service's control. Nevertheless, we can facilitate its use and ensure that we give timely customer service to encourage employers to come forward.

Establishing participation goals for the Audit Closing Agreement Program (Audit CAP) is both difficult and troubling. It is difficult because of the same challenges referenced above relating to predicting plan errors. It is troubling because of the possibility, however remote, that establishing participation goals could affect the exam selection process as well as the outcome of any given case. In addition, there is the question of whether establishing such goals would cause a violation of the prohibition against the use of Records of Tax Enforcement Results (ROTERS) as provided by the Restructuring and Reform Act of 1998.

Corrective Actions:

We will continue to partner with our stakeholders to determine the effect our correction programs have on compliance and to solicit their suggestions on ways to improve the EPCRS.

Implementation Date: June 30, 2004

Responsible Officials: Manager, EP Voluntary Compliance and Director, EP Examinations

Corrective Action Monitoring Plan:

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Treasury Department's Joint Audit Management Enterprise System.

Recommendation 2:

The Director, EP, should develop a process to measure the impact of the marketing and outreach efforts on the desired marketing goals.

Comment:

In November 2002, VC function management worked with the EP Customer Education and Outreach (CE&O) function to create a VC marketing plan with two established goals: (1) to make every plan sponsor aware of the necessity of internal control and monitoring systems for ensuring retirement plans are in

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

4

compliance with the law, and (2) to increase the use of EPCRS correction programs offered by the IRS. The goal of education and outreach is to increase knowledge and awareness; knowledge of the law and a plan sponsor's responsibilities under it so as to reduce the likelihood of error, and awareness of the EPCRS correction programs to help a plan sponsor correct the error. Measuring the impact of educational and marketing efforts on compliance and the use of the EPCRS correction programs presents unique challenges because, in many cases, the change in behavior is intangible. However, there are some tangible acts that may be used as an indication that EP's outreach activities have an impact on compliance.

Corrective Actions:

EP will request that the number of visits during FY 2004 to the correction topic of the Retirement Plans web page on IRS.GOV be tracked. The web page will reflect an on-line version (except for video) of the *Retirement Plan Correction Programs CD-ROM* as well as other information on the correction programs.

In addition, EP will track the number of EPCRS products distributed such as *Retirement Plan Correction Programs CD-ROM* (Publication 4050) and *Retirement Plan Correction Programs Pamphlet* (Publication 4224), as well as the number of speeches delivered by EP representatives and the number of speech attendees. During FY 2004, EP will analyze the feasibility of surveying applicants under the Voluntary Correction Program to help determine the impact of outreach on use of the correction programs. EP will fully use established communication channels to inform customers of the availability of IRS products and web information on EPCRS. Such channels include speeches, Employee Plans News, IRS Retirement Plans web page, IRS Business Web Page, Employee Benefits Security Administration (EBSA) Web Site, SSA/IRS Reporter, other secondary distribution networks of Government partners (such as EBSA, Small Business/Self-Employed, the Small Business Administration, etc.) and external partners.

Implementation Date: September 30, 2004

Responsible Official: Director, EP Customer Education and Outreach

Corrective Action Monitoring Plan:

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Treasury Department's Joint Audit Management Enterprise System.

Recommendation 3:

The Director, EP should implement standardized procedures for determining ACAP sanctions and the significance of plan failures. Also, a process should be developed to ensure these procedures are consistently applied.

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

5

Comment:

One of the primary goals of the EPCRS is the consistent application of the EPCRS principles and correction methods so that similarly situated plans are treated alike. However, because of the natural tension between consistency and flexibility, the goal of consistency is sometimes tempered by matters of equity. This tension sometimes results in a lack of consistency. Nevertheless, we recognize the need to attain more consistency in applying our Audit CAP sanctions and the determination of whether a failure is eligible for the SCP.

EP took many steps toward those goals during FY 2003, some of which you cite in your report. During FY 2003 the Area Coordinators worked to develop a standardized SCP worksheet for Examinations agents and Area Coordinators to use in determining program eligibility. This worksheet will help improve consistency in applying that program. In addition, EP initiated an exploration of the current Audit CAP sanction structure to determine whether we could improve that structure to provide greater consistency of application and increase processing efficiency. The Central Coordination Committee produced six alternate proposals; these have been narrowed down to three, which we are developing and refining.

Corrective Actions:

During FY 2004, we will test these three proposals on exam cases to determine their impact on compliance and consistency. When EP is comfortable with these proposals, it will partner with inside and outside stakeholders in determining the actions to be taken on the Audit CAP sanction structure.

In addition, the Area Coordinators are developing a peer review process to review cases closed under the SCP and the Audit CAP in an effort to promote consistency.

The EP Examination's Compliance Impact Team's Audit CAP and SCP Barriers Sub-team is also addressing consistency issues. One of the recommendations the sub-team made is to develop a website that would promote consistency by providing tools for EP agents related to processes and procedures.

Finally, the Voluntary Compliance organization is also developing an intranet web page that will provide tools to assist in the consistent application of the EPCRS, e.g., closing agreement templates, a catalog of issues addressed by the Central Coordination Committee, and answers to questions received from taxpayers.

Implementation Date: December 31, 2004

Responsible Officials: Manager, EP Voluntary Compliance and Director, EP Examinations

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

6

Corrective Action Monitoring Plan:

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Treasury Department's Joint Audit Management Enterprise System.

Recommendation 4:

The Director, EP should establish appropriate measures to incorporate EPCRS goals into the EP Examinations Program so Examinations employees are accountable for both EPCRS and Examinations goals.

Comment:

We do not believe that we can predict the incidence of plan errors, and we do not want to create a situation in which the establishment of program goals may either affect the exam selection process or the outcome of any case. In addition, establishing such goals might violate the prohibition against the use of Records of Tax Enforcement Results (ROTERS) as provided by the Restructuring and Reform Act of 1998.

Corrective Actions:

The EP Examination's Compliance Impact Team's Sub-team on Audit CAP and SCP Barriers has proposed to add a commitment to each Area Manager's Performance Management System for FY 2004, requiring that they complete visits/conference calls with each group in their Area to evaluate Audit CAP and SCP training needs, communicate the requirement to use the procedures outlined in Revenue Procedure 2003-44 (including ethical implications), and identify and address barriers to using the procedures.

EP management will continue to emphasize to employees the importance of accurately and fairly applying the SCP and Audit CAP.

Implementation Date: September 30, 2004

Responsible Official: Director, EP Examinations

Corrective Action Monitoring Plan:

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Treasury Department's Joint Audit Management Enterprise System.

Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes

7

Recommendation 5:

The Director, EP should reemphasize the proper Examinations closing procedures for operational failures corrected using the SCP.

Comment:

The EP Examination's Compliance Impact Team's Sub-team on Audit CAP and SCP Barriers has identified the need for managers to emphasize that Audit CAP and SCP are the only acceptable ways to close exam cases with identified qualification issues.

Corrective Actions:

We are proposing a commitment for each Area Manager's Performance Management System for FY 2004, as described in the corrective action for recommendation 4.

Implementation Date: September 30, 2004

Responsible Official: Director, EP Examinations

Corrective Action Monitoring Plan:

We will monitor this corrective item through the Business Performance Review Process of the Commissioner of Internal Revenue and the Treasury Department's Joint Audit Management Enterprise System.

If you have any questions about this response, please contact Joyce Kahn at (202) 283-9586.